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The Conference Board

Worldbusiness Perspectives No. 75
October 1983

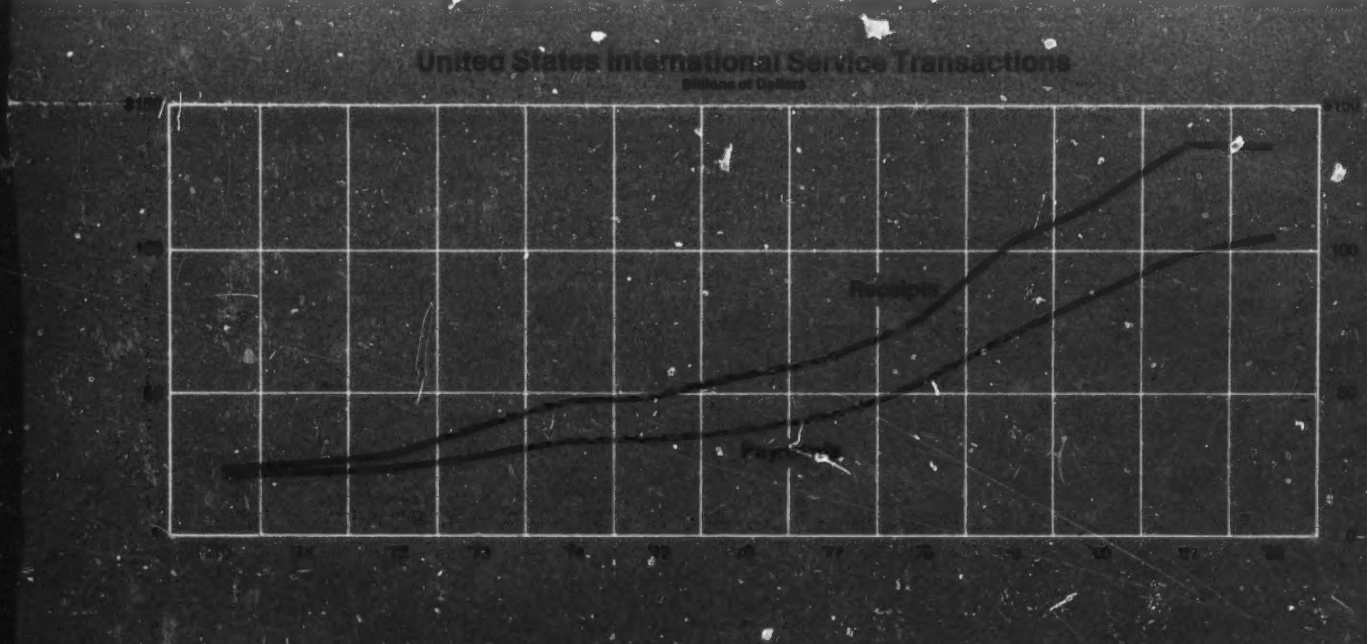
INTERNATIONAL TRADE IN SERVICES

A Growing Force in the World Economy

In taking a measure of the international position of the United States, both the media and public discussion generally tend to focus on this country's foreign trade and on its trade balance. Much less attention has been paid, at least until recently, to transactions in services. Yet, the domestic services sector and international trade in services are becoming progressively more important in the economies of both the United States and the other industrial countries.

In the United States, this sector now accounts for close to half of the gross national product, and for seven out of every ten nonfarm jobs. This year, *Fortune* included ten companies from its 1982 list of the 500 largest industrial companies—including RCA and Avco Corporation—in a newly compiled Service 500 Directory, on the grounds that their sales from manufacturing activities had slipped below 50 percent of total sales.

Of course, not all types of services are—or can be—traded internationally. But a recent analysis by the International Monetary Fund (IMF) has shown that the value of international service transactions more than doubled in the 1960's, and during the 1970's, when merchandise trade increased by 6 percent a year, grew by 17 percent annually. For 1980, the IMF puts international trade in services at an estimated $650 billion, as against global merchandise exports of $1,870 billion. Thus, services now account for about one quarter of exports of goods and services combined. For such countries as the United States and the United Kingdom, the proportion is considerably higher—roughly 35 to 40 percent of overall trade.



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Services in the U.S. International Accounts

The neglect of services in appraising the U.S. international position is somewhat understandable. Merchandise represents something hard and tangible, easily understood and counted, and moreover, is available on a month-to-month basis. Services, on the other hand, comprise a heterogeneous assortment of transactions that does not lend itself easily to straightforward analysis (see box); data are published only quarterly.

United States trade in services emerged in the mid-1970's as an important contributor to this country's balance of payments. At a time when our merchandise trade was characterized by almost continuous deficits, trade in services continued to show surpluses—rising from $14 billion in 1975 to $32 billion in 1979, and $39 billion in 1981. Services thus were an important element in the overall current-account surpluses registered in 1980 and 1981. In 1982, service receipts ($137 billion) and payments ($104 billion) accounted for 39 and 30 percent, respectively, of receipts and payments for goods and services combined.

International transactions in services comprise a great variety of activities and reflect many different types of economic behavior and economic forces. No single category can, therefore, explain movements in the service account as a whole. Yet, as the chart on page 3 indicates, that account is dominated by investment income and by travel and transportation expenditures. Net investment income is the largest single determinant of the U.S. service account; of the $33.2 billion surplus in 1982, $27.3 billion reflected net investment receipts. For further analysis, it makes sense to distinguish between income derived from direct investment and from financial assets, both private and official.

The United States has been in a net creditor position on *direct* investment throughout the post-World War II period, reflecting the worldwide expansion of U.S. multinational firms. U.S. foreign direct investment at the end of 1982 amounted to over $220 billion, accounting for 27 percent of total United States assets abroad. By contrast—and despite the rapid establishment of foreign-owned enterprises in this country—at the end of last year, foreign direct investment in the United States totaled only $100 billion, or 15 percent of total foreign assets in this country. Given this disparity, it is not surprising that income on direct investment has always been in excess of payments. In fact, the difference between the two—or net income on direct investment—rose by one half, to $25 billion, between 1977 and 1981.

Net United States income on *financial* (or portfolio) investment has also grown rapidly over the past five years or so. Both receipts and payments have at least tripled as both the stock of assets and liabilities and their respective rates of return have increased. In fact, many types of United States international financial transactions have raised both United States international assets and liabilities, and simply reflect the large role played by the dollar in global financial dealings and the position of this country as a "giver and taker" of funds in the world.

Services: Some Definitions

The service account in the balance of payments has been described as "a composite of many dissimilar types of transactions." Yet, these have a common denominator since they involve selling or buying part of the output of the United States and its trading partners, or providing a return on United States capital invested abroad in a previous period, or on foreign capital invested in this country.

The largest single category, *investment income*, represents payments and receipts of income on direct investments and other internationally held private and government assets, including bank and commercial loans. *Travel and transportation*, the second largest item, includes all expenditures connected with the international movement of people and goods, such as passenger fares and freight. It also includes expenditures on goods and services made by travelers outside their countries of residence.

Fees and royalties consist of payments by both firms and individuals for the use of technology, intangible property, and managerial services. *Military transfers* reflect provision of goods and services to foreign governments under United States military sales contracts. On the payments side, *defense expenditures* include goods and services purchased abroad by both the Department of Defense and United States military personnel. *Other services* show payments and receipts on private services such as construction, finance and insurance, as well as on government services not covered elsewhere (such as foreign expenditures by nonmilitary agencies and personnel).

Not included under services are private remittances, government grants, and other unilateral transfers—although these are often grouped with services under the heading of "invisibles." Merchandise trade and invisibles together constitute the so-called current-account transactions, the net balance on which is the broadest measure of the United States balance-of-payments position.

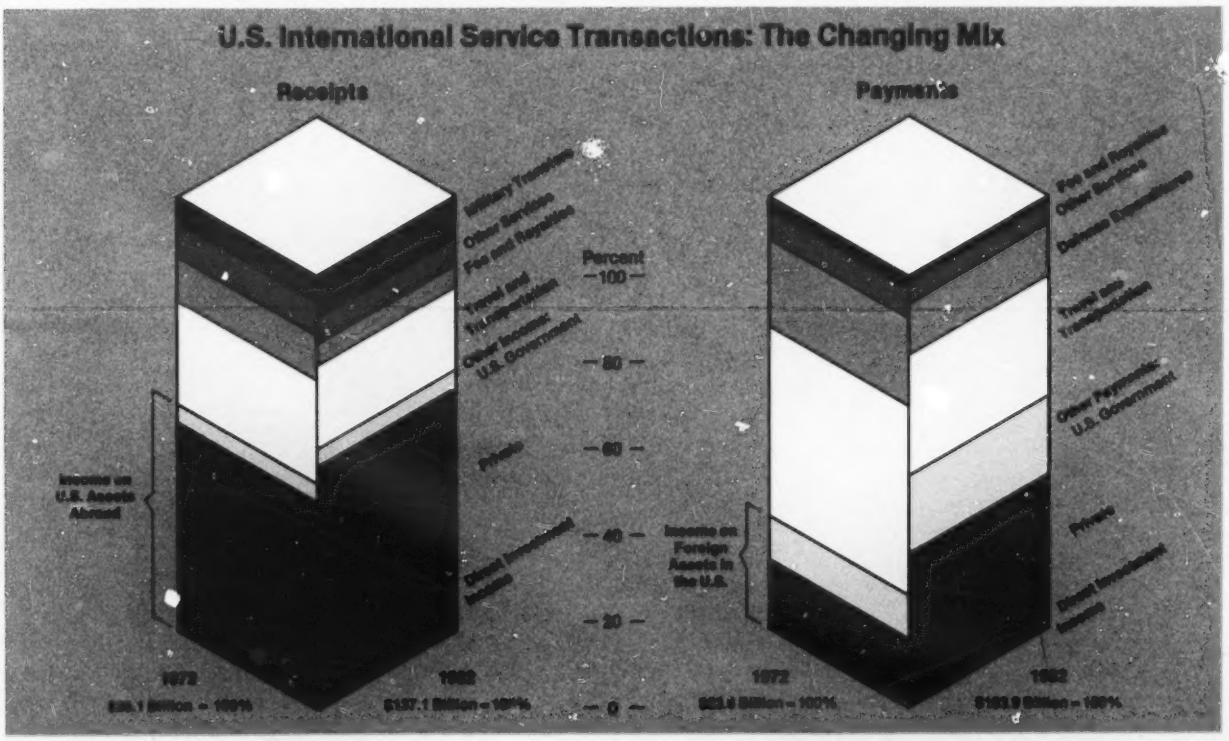
Services and the Global Balance of Payments

In an ideal world, both an individual country's international transactions, and the various countries' surpluses and deficits in their transactions with each other, ought to cancel out to zero. As it is, in both cases there is a statistical imbalance—formerly termed "errors and omissions" by the United States, but now called "statistical discrepancy" in this country and "statistical asymmetry" by the IMF—which has grown enormously in recent years. For the world as a whole, this summing of imbalances ranged between $4 and $16 billion annually in the second half of the 1970's; rose to $20 billion in 1980; more than doubled in 1981; and doubled once more to $89 billion last year.

To some extent, this growth reflects the more or less steady growth of world trade and world financial transactions, and the sheer increase in the numbers reported. But, more important, the asymmetry also reflects deficiencies in the ordinary balance-of-payments reporting of individual countries; incorrect allowance for transactions with nonreporting countries (i.e., nonmembers of the IMF) and international organizations; and clandestine or illegal transactions that escape the reporting net altogether. According to IMF data, the global asymmetry typically consists of a net surplus on merchandise trade and a much larger net deficit on services. The latter has become especially marked: In relation to the average flow of service receipts and payments, the global deficit has risen to 10 to 11 percent of the total.

While the IMF found that in the longer run "the invisibles deficit has been fairly stable in ratio terms," that is, as percent of gross flows, it also discovered that the largest single category within the asymmetry was "other investment income." This shortfall, the analysis concluded, was no doubt rooted in the greater ease of tabulating payments than receipts, since payers tend to be larger, fewer and more readily identifiable than the final recipients. The latter, the IMF says, "tend to be numerous, scattered, and often interested, for reasons relating to taxes or exchange controls, in avoiding regular channels." Another source of difficulty is that such earnings (recorded as payments to nonresidents) often are not repatriated, but are simply credited to an account in the country of payment. Because of these and related circumstances, a systematic underrecording of receipts from financial investment income occurs worldwide. As this type of transaction grows in value, a worsening of the global asymmetry on services—and hence on overall international transactions—is to be expected.

With the United States alone accounting for more than one-fifth of world service receipts, part of the



Source: Department of Commerce

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global discrepancy may well reflect a serious understatement of net U.S. service income. Receipts from transportation services, investment income, and fees—three areas in which the United States is strong—are especially difficult to capture accurately. The idea has, therefore, taken hold that the reported United States balance-of-payments deficits may well be somewhat overstated.

Barriers to Trade in Services

Both the growth of the service sector and, more important, the recent worldwide buildup of protectionist pressures have focused increased attention on international transactions in services. However, no effort has been made to date to provide a general framework of rules to govern this substantial volume of transactions: The General Agreement on Tariffs and Trade (GATT) covers only merchandise dealings. But the argument has been made that the principles which led to the adoption of a body or code or rules for merchandise trade at the end of World War II apply with equal force to trade in services. Or, as United States Special Trade Representative William Brock has put it: "It is insane to think that you can long continue to trade in goods if you have barriers to the services which facilitate the trade in these goods. The two are totally intertwined, and you can't separate them."

Little wonder, then, that services and their regulation occupied a prominent spot on the agenda of the GATT ministerial meeting in Geneva in November, 1982. At that meeting, the United States submitted a 13-category "Illustrative Summary of Impediments to Trade in Services" to serve as a basis for discussion. United States officials expressed their keen desire to begin international consideration of a framework within which subsequent negotiations could be conducted. The United States objective was—and is—not to seek uniformity of national rules governing the services industries, but rather to ensure that foreign services firms within each country are treated in the same way as national ones.

The meeting produced no commitment for direct action or even for a comprehensive GATT report on the issue, but merely encouraged individual countries to study the relevant problems on their own. Meanwhile, in April, 1983, the London-based private Trade Policy Research Centre established a high-powered committee of bankers, businesspeople and politicians to examine further the services sector and to frame proposals for international regulation. Headed by Ambassador Robert Strauss, the United States Trade Representative under the Carter Administration, the committee agreed on a study of internationally agreed-upon objectives, principles and rules with respect to trade in services, paying particular attention to the growing impact of technology on the structure and activities of service industries. This would include the proliferation of national restrictions on international information and data flows. The committee's report is expected to be presented at the next GATT ministerial meeting in 1984 or 1985.

In a separate action in the United States, leaders of 20 companies in telecommunications, construction and engineering, banking, insurance, and other services sectors, earlier this year established the Coalition of Service Industries (CSI). The group's aim is to strengthen the voice of service industries in the formulation of domestic and international economic policy.

This development is of special interest, since the growing service sector within the United States economy is expected to become a major force internationally—and one in which the United States has a comparative advantage. It has been estimated that international disparities in productivity growth have not been quite as unfavorable to the United States in service activities as in the traditional manufacturing sectors. The relative unit labor-cost position of the United States may be considerably stronger in services than in other activities.

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The Conference Board

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November 1983

BANKERS VIEW EXPORT TRADING COMPANIES

A Special Report

The U.S. banking community is responding with caution to legislation permitting it to engage in export trading operations. A joint survey by the Bank Administration Institute and The Conference Board drew responses from one bank that has already formed an export trading company (ETC) and 33 that are considering formation. The remaining 126 respondents reported that they had no plans to create a trading company.

The survey was conducted in August, 1983, by the Bank Administration Institute, using a mailed questionnaire to the nation's 1,000 largest banks. Respondents were asked if they were considering the formation of an ETC, the factors that were being considered in the evaluation of an ETC, and their feelings about the adequacy of the legislation.

Deciding Against An ETC

The majority of respondents—126 out of 160—report their banks are not considering forming an ETC. In a few instances, the decision was based upon studies by bank staff of the export potential of firms in the bank's service area. In most cases, however, the decision was reached on the basis of informal meetings and conversations.

Most of these banks concluded that the subject did not warrant further investigation, and in only a few instances was a formal decision made not to form an ETC. Many of the banks that chose not to pursue the question of ETC's indicated that the subject might be raised again at a later date, but their immediate decision was not to form an ETC.

No Perceived Need

"A limited customer base and prospects" was the conclusion of a midwestern bank that opted against an ETC, a conclusion that was shared by many others in the group deciding against this step. The perceived lack of demand for a bank-owned ETC—cited by one-third of the 126 respondents—was the factor cited most frequently.

Several banks report that the lack of exports from their service area make even the formation of an international department within the bank unnecessary; consequently, an ETC is certainly not required. In most cases, the relatively small number of firms in the bank's service area engaged in exporting appeared to be the major constraint limiting overseas sales. Some banks were able to point to a few firms in their customer base whose exports are sizable, but these firms, according to the banks, are large enough to finance their own export transactions. One bank, in fact, indicated that the major exporter in its area was so large that the potential financing through an ETC formed by the bank would not be sufficient to meet the exporter's needs.

The survey responses suggest that as these banks become more familiar with the operations of an ETC, they may seek partners in forming one. In some cases, the partners will be other banks that will be able to expand the volume of loanable funds. In other cases, banks will seek partners that have expertise in international trade, particularly barter trade.

A few banks indicated that the decision not to pursue the formation of an ETC resulted not so much from the small export potential of the service areas as from the operating strategy of the bank itself. "Our research indicates that an ETC should be undertaken only by the very largest international banks," was the conclusion of one respondent. This conclusion is very similar to the bank that believes that ETC's would "be limited to the larger banks who have or can acquire the expertise" needed to export. The respondent for a New Jersey bank stated simply that "we are a conservative bank," as its argument against formation of an ETC.

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The perception that ETC's are investment vehicles appropriate only for larger banks was evident in the responses of several banks that were members of large-scale holding companies. One bank reports it is "an affiliate of a $5-billion holding company with its principal subsidiary bank located in a major city, and it has an international department. If an ETC were to be considered, it would be a holding-company decision." Another bank indicated that it did not have the option of evaluating an ETC; its parent had "charged" it with activities only in its own community.

A variation of the theme that size is a prerequisite for ETC's was struck by another bank: "We do not have customers willing to use local financial institutions for this service. We are too close to Chicago."

Experience

Next to a perceived lack of need, inexperience in international trade is the factor cited most frequently by banks that have decided against formation of an ETC. In part, this lack of experience reflects the needs of customers who, by and large, sell only in domestic markets. The lack of experience, however, extends beyond an unfamiliarity with U.S. export transactions. Between 20 and 25 percent of total world trade in the early 1980's was in the form of barter and countertrade, according to the application by Citicorp to the Federal Reserve to form an ETC. Thus, U.S. firms selling abroad may be paid in goods or commodities which may or may not be saleable in the United States. As a result, trading companies must not only be aware of the problems associated with financing, transporting and selling U.S. products in foreign markets, but must also be adept at marketing goods produced by the buyer (or other firms in the country of the buyer) in third markets.

The background and experience needed for selling and trading in international markets is not normally developed internally by banks. Several respondents indicate that their participation in an ETC would depend upon their ability to identify individuals or firms with these skills that would be willing to participate in the ETC. Locating these skills, however, does not completely solve a bank's problems. Individuals with trading skills are accustomed to working with relatively little supervision; additionally, the salaries and bonuses earned are usually much higher than compensation paid bank employees of similar age and work experience. Thus, the integration of the personnel and activities of an ETC into the more traditional aspects of a bank's business can be a troublesome, although by no means an insurmountable, problem for a bank.

A few banks are tackling this problem by physically separating the offices of the ETC from the bank. The activities of the ETC are monitored by senior bank personnel but little day-to-day supervision is exerted. The compensation system, including bonuses, is different from that for other bank employees.

Low Priority

Roughly one out of every ten banks that reported they were not forming an ETC said that there were more important areas on which the bank should focus. "There seem to be too many other high-priority areas for profit improvement," said one banker. This was the same conclusion reached by a Nebraska colleague who wrote that "currently there are a number of more effective alternative investments."

In other cases, however, maintaining existing profits rather than searching for new areas of growth was the factor that relegated ETC's to a low level of priority. "The banking community and the economy have had enough problems for the past three years," wrote one banker who noted that the changes created by deregulation were important areas of concern for the bank. The 1982 Act is itself, of course, a type of deregulation, but export financing and servicing are often of secondary concern to banks that are encountering competition from nonbanking sources, and are devising new investment vehicles and strategies to meet this competition.

For some banks, ETC's might assume a higher priority if the concept were better understood. A Virginia bank has not given ETC's full consideration "because of not knowing much about the mechanics or profitability of such a venture." This is a sentiment echoed by a Pennsylvania bank that knows "practically nothing about an ETC. We have no idea what the advantages would be, or how we would operate."

The profit potential of an ETC has been particularly difficult for banks to determine. Under the 1982 legislation, banks can take title to the goods to be exported, but the difficulty of determining profit margins in foreign markets is a deterrent factor for one bank. Financing exports is an area in which many banks feel more comfortable, but a bank that simply wishes to finance exports does not need an ETC in order to do so. The market research, advertising and other services that a bank is permitted now to perform for exporters could generate sizable revenues; but, again, these are areas that banks have not traditionally engaged in, and an accurate calculation of potential profit is difficult.

For a few banks, an ETC has a low level of priority because they do not wish to expand their involvement in exports beyond current levels. Not many banks would agree with a Southeastern banker who believes that "The Act was not necessary, and should never have been enacted." But some banks do support the statement of a Michigan bank that has decided against

an ETC because: "We feel that we can do most things except take title to goods in our existing situation."

A few banks have opted against ETC's not because existing bank services are believed satisfactory but because services offered by nonfinancial corporations are deemed adequate. These banks say that they either cannot or do not wish to compete against existing trading companies or against companies that offer exporting services that banks are now permitted to provide. A Texas bank concludes that: "Aside from substantial start-up costs, an ETC would put us in the same business as some customers. That is not our purpose and, consequently, an ETC is not under consideration at this time."

The impact of an ETC upon customers is of concern to many banks. Some banks believe that exporting companies would be better served if the bank took a larger role in developing markets for the export-related services offered by its customers, rather than providing these services directly through a bank-owned ETC.

In addition to competing with customers, the question of servicing some customers but not others is also troublesome. This situation arises if a bank forms an ETC in partnership with serveral firms in the same industry. If all of the firms in the industry that are in the bank's service area are not members of the ETC, the bank may lose these firms as customers.

The provisions of the 1982 Act that permit banks to engage in areas of commerce formerly prohibited thus is forcing a reappraisal of customer relationships. The Act also is changing the competitive environment in which banks operate. The Act permits formation of ETC's not only by banks and other private-sector companies, but by public agencies as well. To date, participation by these groups have been limited. However, the possibility of a bank competing for export revenues with an ETC that includes a public agency is not relished by banks already alarmed by the new sources of competition that have emerged in the past several years.

Advantages of an ETC for Banks

The 1982 legislation is a year old and to date (November, 1983) 14 banks have filed applications with the Federal Reserve Board for permission to form an ETC. One of those banks responded to this survey. As noted earlier, 33 other banks report that they are currently determining whether or not to form an ETC, and that their decision would be made on the basis of the factors discussed below.

Typical of banks that are in the process of consideration is one that is analyzing the prospects of an ETC because of the "opportunity to offer a new service, complementary to what we already provide, and interest on the part of several corporate clients." The bank's final decision will be based on a determination of: "(1)

EXPORT TRADING COMPANIES

The Export Trading Company Act of 1982 is a "search and destroy" piece of legislation designed to reduce some of the obstacles that impede U.S. exports. The Act, which permits banks to form or become partners in export trading companies (ETC's), is intended to provide increased access to funds for U.S. firms selling in international markets. Indeed, banks can now take direct title to goods produced in the United States and sell these goods abroad, if they so wish. Banks can also provide legal assistance, market research, transportation (including trade documentation and freight forwarding), advertising and other services for exporters.

The Act also limits antitrust barriers that may apply when companies producing the same or similar products cooperate in a joint sales effort. The U.S. Department of Commerce is authorized by the Act to grant certificates that provide ETC's with limited antitrust exemption. An ETC that can demonstrate that its activities will not adversely affect prices or competition in the United States is, by virtue of the certificate, partially exempt from criminal and civil antitrust suits under federal and state law.

The Act is significant for banks for a number of reasons. The Act is explicit in giving banks permission to engage in areas of commerce that were formerly prohibited—or believed to be prohibited. Congressional supporters of the Act made it clear that they were doing more than simply drafting legislation that removed barriers to bank participation in exporting: The Act is actually intended to encourage banks to assume a larger role in working directly with exporters. The Federal Reserve Board, which initially had reservations concerning the advisability of encouraging banks to engage in commercial, nonbanking activities, has moderated its objections. The FRB has, in fact, provided considerable assistance to banks in interpreting the provisions of the Act.

The Act is also an important part of congressional and administrative efforts to increase exports. According to supporters of this legislation its chief advantages are: (1) reducing the expense and the time required to develop sales in foreign markets that discourage U.S., firms; (2) providing access to the funding and international contacts and know-how of banks will enable U.S. companies to compete more effectively abroad; and (3) permitting banks to share directly in the profits generated by expanded exports may make banks more aggressive in helping U.S. firms to export.

anticipated profitability; (2) availability of competent management; (3) sufficient interest on the part of our corporate clients to use the services of the trading company."

As indicated earlier, a large number of banks decided not to pursue consideration of an ETC because they did not detect a need on the part of their customers. Not surprisingly, those in the process of deciding if they should form an ETC are assessing their customers' need for export-related services. One bank, in fact, intitiated it's analysis when a customer extended an invitation to become a partner in an ETC. Another bank writes that "the interest expressed on the part of our good customers" was a major factor in prompting consideration of an ETC. A final decision will hinge upon "the commitment on the part of our customer(s) to *form an ETC with us"* (emphasis added). Several banks expressed fears that their customer base might be eroded if an ETC were not formed. For some banks, the competition to service and finance exports came directly from other banks in the community, but one bank cited the need for an ETC in order to "protect" customers from banks in money centers.

While most banks considering formation of an ETC point to the needs of their customers as a major motivating factor, there are questions about the profitability of ETC's. While none of the banks felt that an ETC would be an unprofitable undertaking, the fact that there are, as one bank put it, "no models with a financial track record as yet" is reason for caution. One bank officer cited three factors that will determine his bank's decision, and all three revolve mainly around financial considerations:

(1) the potential for developing additional business from the existing customer base;
(2) the capital requirements to set up the trading company; and
(3) the risk exposures against the benefits of this type of business.

Not every bank places such a heavy emphasis on financial considerations, but "projected rate of return," "impact on bank's profits," "profitability," "generation of fee income," and "capital requirements" figure importantly in virtually every bank's assessment of an ETC.

Another consideration is the availability of management and trading skills. One bank will buy rather than form an ETC in order to obtain these skills; another is seeking association with a group that can provide a sales force in countries targeted for exports. A West Coast bank that has a majority interest in a Dutch trading company and a New York-based coffee house will utilize this expertise in international trade markets if an ETC is formed.

One bank is wrestling with the question of whether its ETC should be formed around a specific industry and a specific geographic market. Other banks have indicated that while intitial operations might be confined to specific products and/or industries, the very nature of trading will take them into other areas. "Market-driven" or "product-driven" ETC's that begin operations with specific areas of activity say they expect (or at least do not rule out) the expansion of these areas as opportunities arise because of (1) identification of exporters in several industries in their service area, and (2) identification of sales potential in several different georgraphical areas. Additionally, U.S. exports, paid for in foreign currencies which may have limited acceptability in world money markets, may force traders to deal in countertrade involving commodities with which they have not had previous experience.

David Bauer

Note: Assistance in preparing this article was provided by James Greene, Executive Director of the International Business Management Program at The Conference Board; and Shashibir S. Sarang, Principal Research Manager, International Banking Group, Bank Administration Institute.

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FOREIGN CAPITAL EXPENDITURES BY US COMPANIES

Upturn in 1984

Plans for capital spending outside the United States by American manufacturing corporations appear to be on the upswing in 1984. More than one-third of the companies responding to the October, 1983, survey of The Conference Board plan to spend more abroad in 1984 than they did in 1983. At the same time, there was a significant drop in the percentage of companies planning to spend less, while the percentage of companies planning to spend about the same held steady.

This moderately good news must be tempered, however, by the fact that plans for 1983 represented a low point in the history of this survey. When last queried in April, 1983, only 21 percent of the companies replied that they expected to raise their 1983 capital spending over 1982. This percentage was the lowest in the whole 13-year record of this survey.

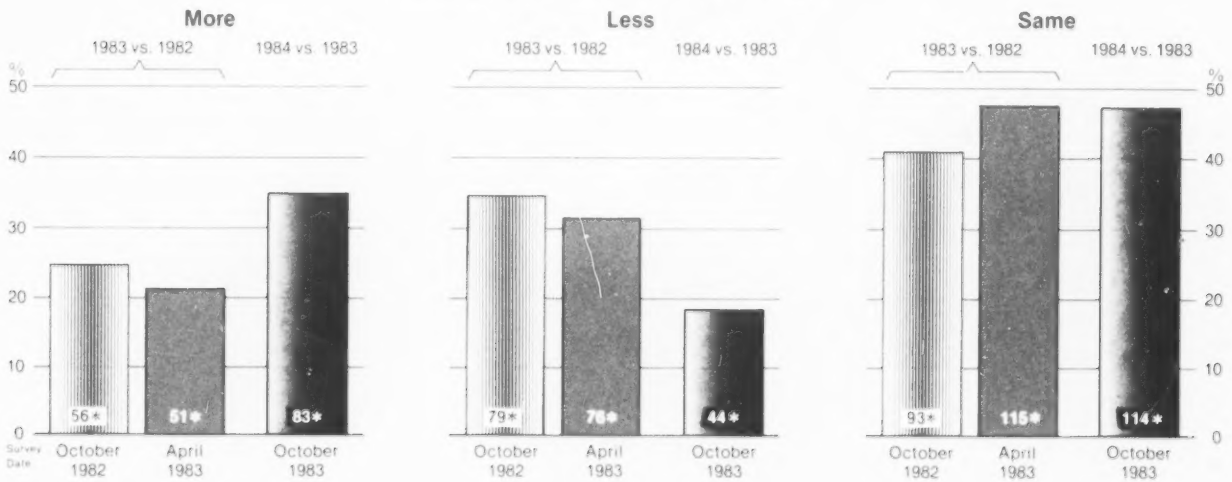
The survey conducted by The Conference Board is aimed only at comparing the direction of current investment intentions with past levels on a company-by-company basis, without seeking dollar magnitudes. In the June, 1983, survey of the Department of Commerce (the latest aimed at estimating capital spending in dollars), manufacturers (including petroleum companies) stated that they expected to spend about $38 billion in 1984, a 7 percent increase over the preceding year. This increase returns expenditures to only slightly above the 1982 level.

In "real terms," 1984 spending will actually be below the 1982 level. Worldwide inflation shows a sharp drop over the past three years, but even so, at approximately an annual rate of 13 percent globally in 1983, inflation has clearly outpaced the growth in capital expenditures.

J. Frank Gaston

Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend:



*Number of companies

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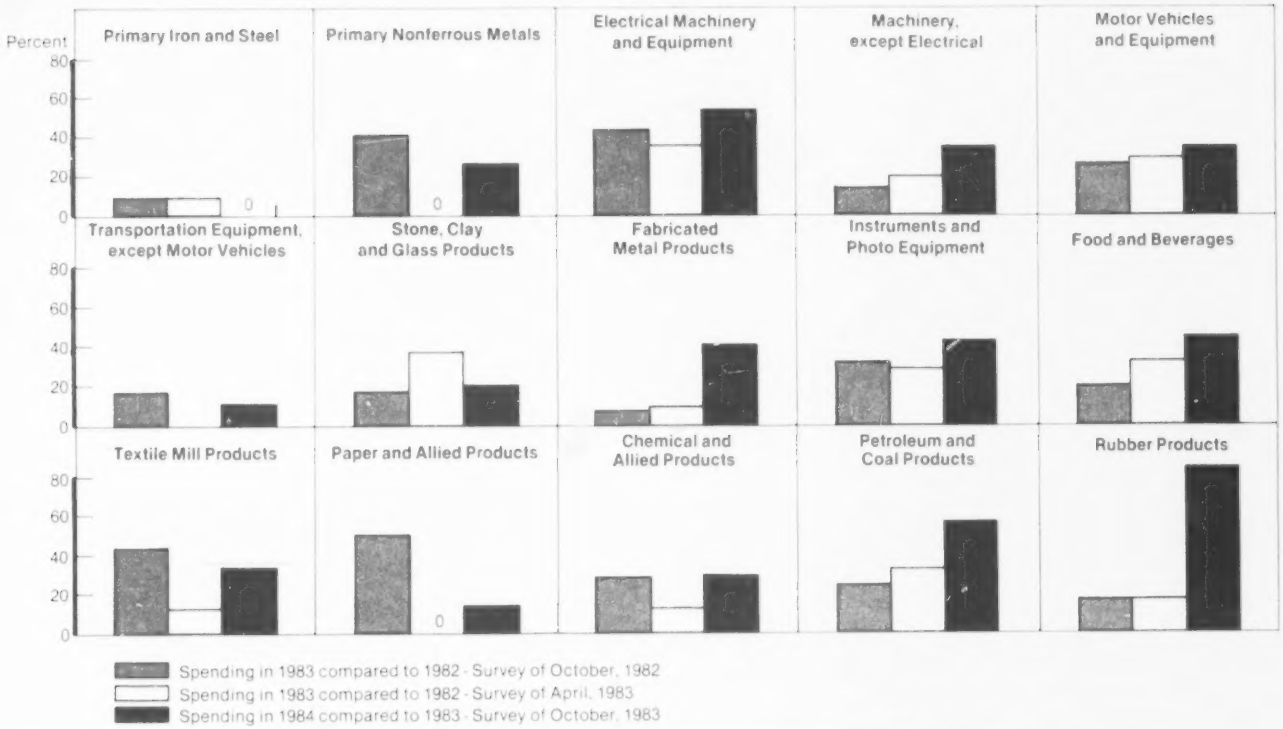
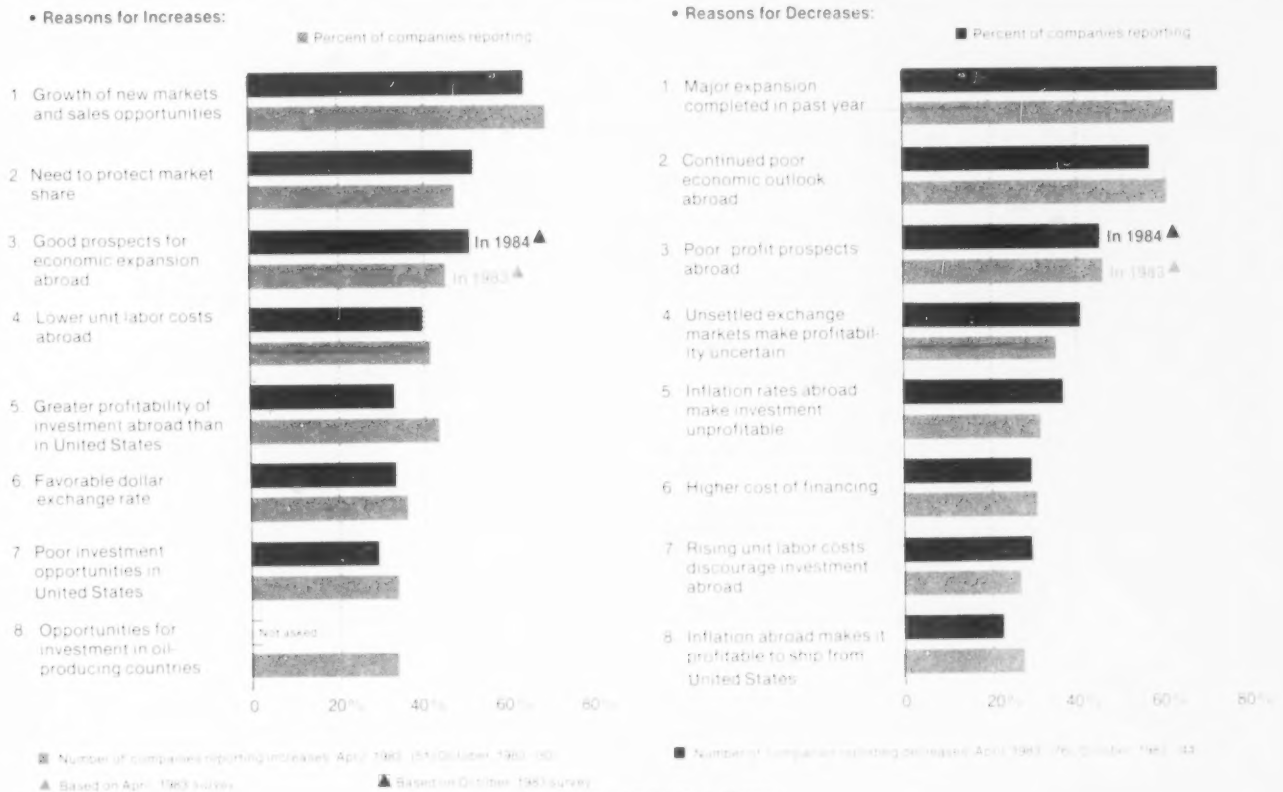
Spending Plans for Plant and Equipment Outside the United States by Industry

Percent of Companies Planning to Spend More



Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing


• Reasons for Increases:
Percent of companies reporting
1. Growth of new markets and sales opportunities
2. Need to protect market share
3. Good prospects for economic expansion abroad
4. Lower unit labor costs abroad
5. Greater profitability of investment abroad than in United States
6. Favorable dollar exchange rate
7. Poor investment opportunities in United States
8. Opportunities for investment in oil-producing countries
In 1984 ▲
In 1983 ▲
Not asked
0
20%
40%
60%
80%
▲ Based on April 1983 survey
▲ Based on October 1983 survey
• Reasons for Decreases:
Percent of companies reporting
1. Major expansion completed in past year
2. Continued poor economic outlook abroad
3. Poor profit prospects abroad
4. Unsettled exchange markets make profitability uncertain
5. Inflation rates abroad make investment unprofitable
6. Higher cost of financing
7. Rising unit labor costs discourage investment abroad
8. Inflation abroad makes it profitable to ship from United States
In 1984 ▲
In 1983 ▲
0
20%
40%
60%
80%

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The Conference Board

Worldbusiness Perspectives No. 78
February 1984

FOREIGN INVESTMENT IN THE U.S.
A Tentative Upswing

Foreign manufacturing investments in the United States rose last year for the first time in four years. After reaching a peak of 431 in 1979, the number of investments declined steadily to 271 in 1982. Investments increased last year to 280, only a nominal gain over the prior year but nevertheless an indication that the drop of previous years may have ended.

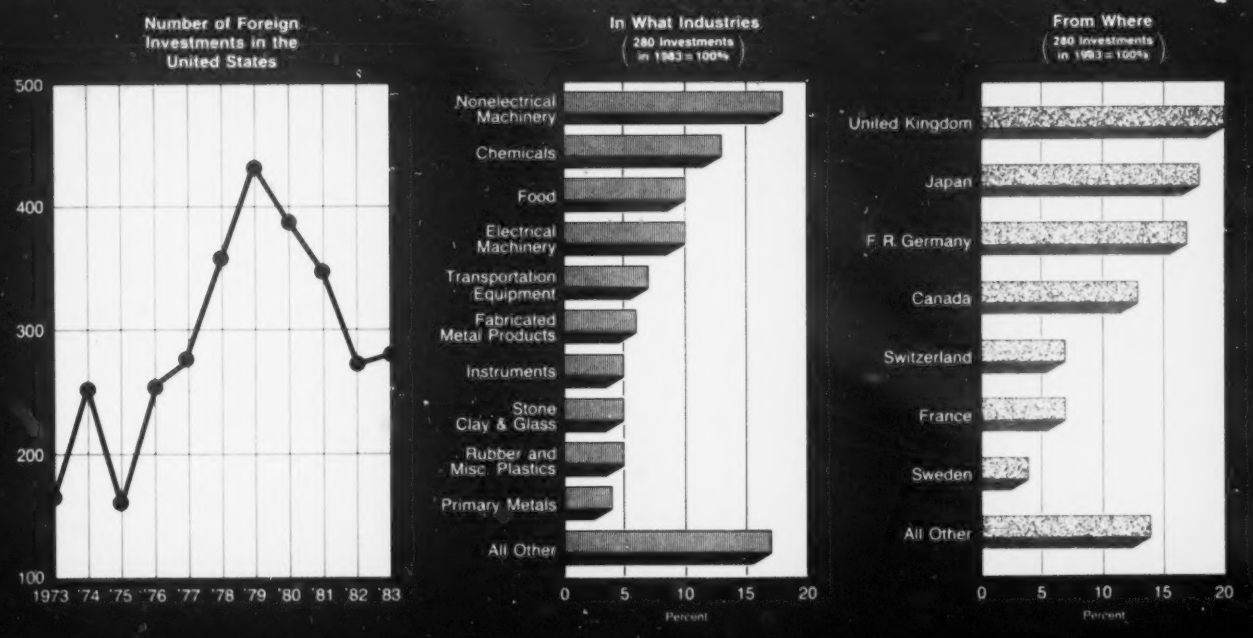
A continued pickup in investments is contingent upon the strength of the economy. Most economists polled by The Conference Board look for gains in real GNP of 5 percent in 1984 and 3 to 4 percent in 1985.[1] These increases may be sufficient to convince foreign companies that the calamitous decline in incomes earned by their U.S. affiliates will be reversed, and that the United States is again a profitable area for new investments.

The poor income performance of U.S. affiliates in recent years can hardly be overstated. The combined income of these affiliates in 1980 was $2.4 billion, up sharply from the $900 million earned in 1977. During the 1981 recession however, income fell to $934 million, and to only $21 million in 1982.

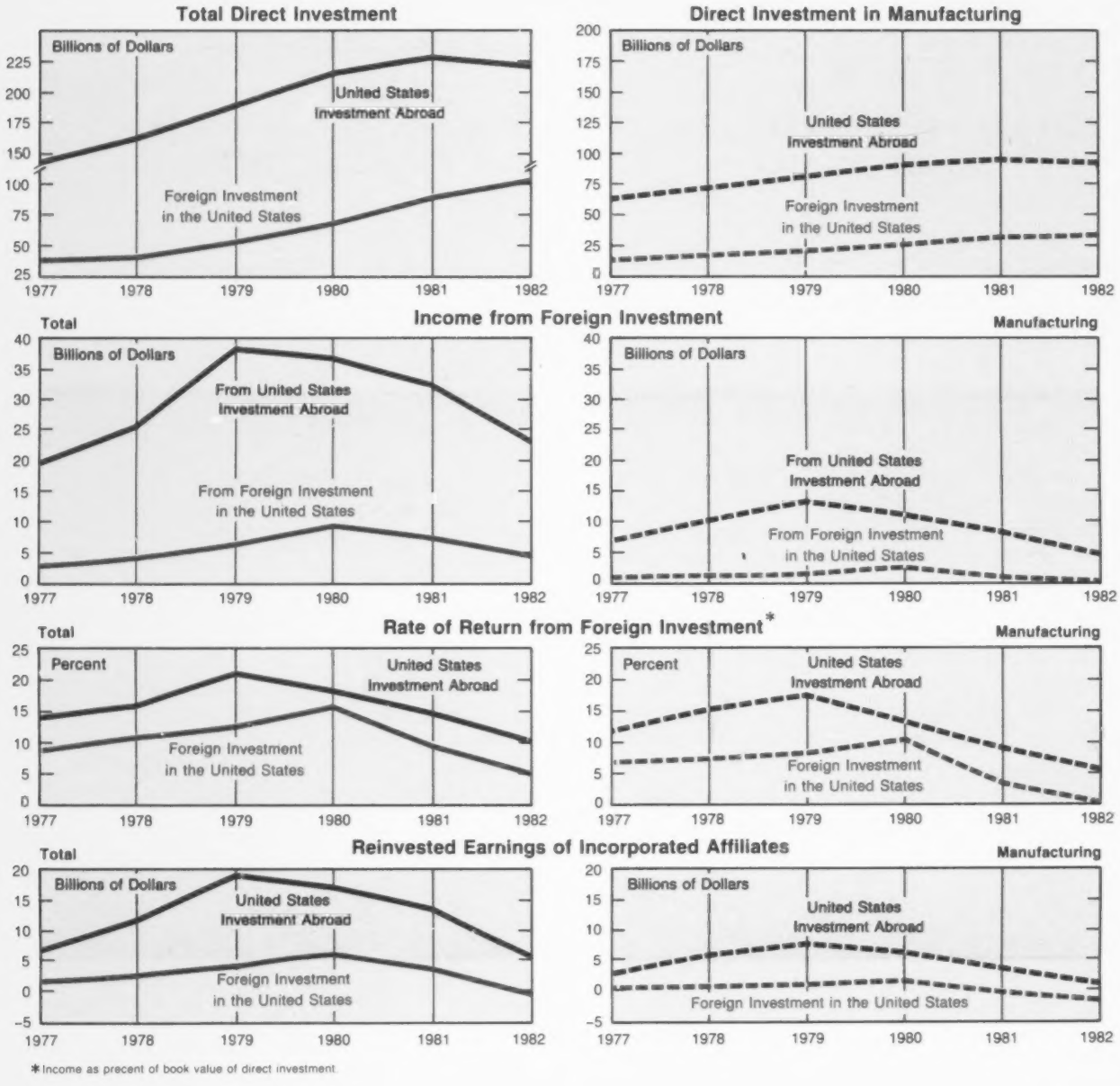
Between 1981 and 1982, the food processing industry was the only major manufacturing sector in which affiliates were able to show increases in incomes. A substantial number of the foreign food companies in the United States are European, and firms from the Netherlands and England accounted for nearly all of the income earned in 1982. Affiliates in the metals industries suffered

[1]These projections are included in the "Statistical Bulletin," a monthly Conference Board publication.

Foreign Investments in U.S. Manufacturing



Perspective on Direct Foreign Investment in the United States, 1977-1982



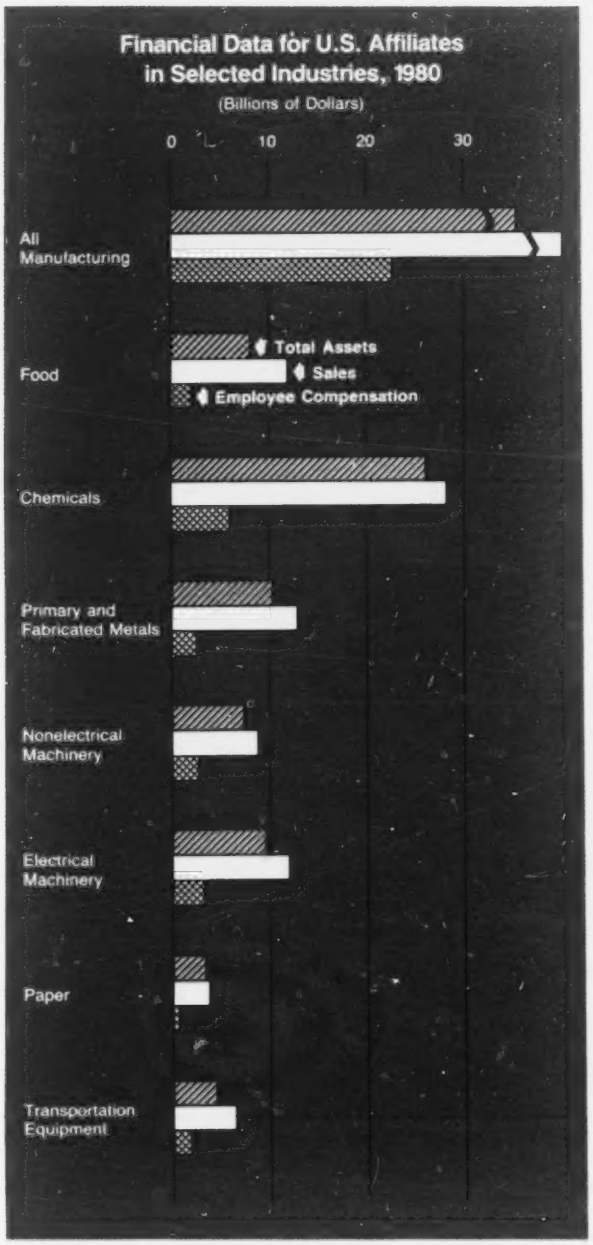
*Income as precent of book value of direct investment.

substantial declines in income primarily because of losses incurred by affiliates of Swiss and French firms. In the transportation sector, West German-owned affiliates producing automobiles and parts had losses in 1982 as compared to net incomes in 1981.

Data on affiliates' income earned in 1983 are not yet available, but the excellent year enjoyed by many U.S. companies suggests that affiliates may also have improved their sales and income. If so, the results may translate into another increase in the number of investments in 1984, although the gain will probably be moderate in comparison to those recorded prior to 1980.

A Profile of Investments in 1983

The book value of foreign manufacturing investments in 1983 was estimated by The Board to be in excess of $32 billion[2] This figure essentially represents foreign companies' equity in, and net outstanding loans to, U.S. affiliates.

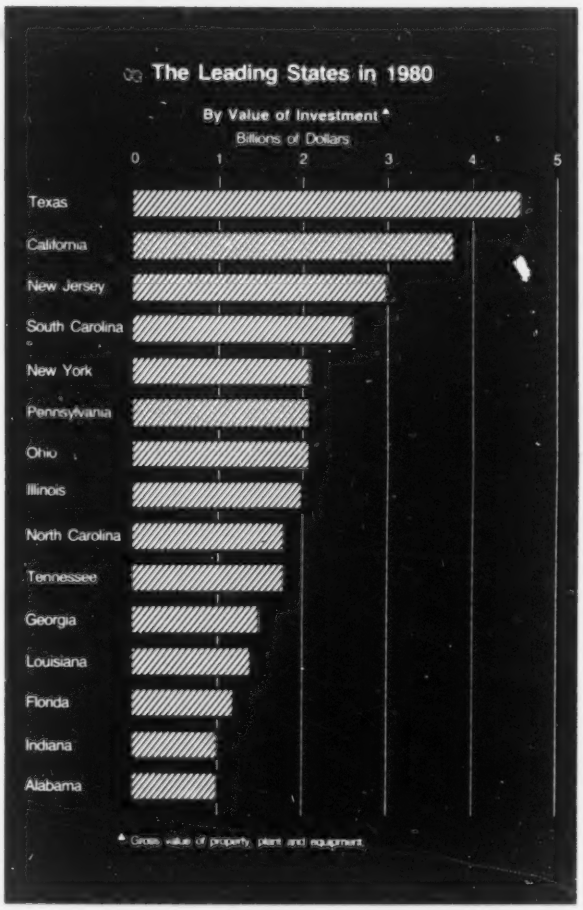


As in the case with data on incomes, 1983 actual figures on book value will not be available until the latter part of 1984, when they are released by the U.S. Department of Commerce. Figures compiled by The Conference Board on the number—as opposed to book value—of investments during 1983 show that English firms accounted from 57 of the 280 investments announced during 1983, followed by firms from Japan (49), West Germany (47), Canada (36), Switzerland (20), and France (19).

These countries have traditionally accounted for the largest share of investments in this country, although in recent years a number of firms from smaller countries have been active investors. In 1983, the Huhtamaki Group of Finland acquired several U.S. producers of confectionery and snack foods. The South Korean firms of Samsung Electronics and Hyundai announced plans to construct plants to produce furniture, television sets, semiconductors and other electronic products. Investments by South Korean and Taiwanese firms (Formosa Plastics acquired several U.S. pipe-making plants in 1983) are viewed by some observers as a repetition by the newly industrialized countries (NIC's) of strategies of European and Japanese firms during the 1960's and 1970's: U.S. sales were first established by exports and the sales base was then expanded by building U.S. production facilities.

Investment by Industry

As in previous years, the number of investments in nonelectrical machinery were larger than in any other ma-



[2]The book value of foreign investment by U.S. firms in 1982 was $221 billion, down 2 percent from the 1981 level. The decline, which was the first in over 30 years, occurred as U.S. companies borrowed heavily from their foreign affiliates and sold some of their Canadian subsidiaries.

jor industrial sector. "Nonelectrical machinery" encompasses a broad number of products although computers and related equipment (random access memory chips, keyboards, parts for microcomputers, etc.) accounted for roughly one-out-of-every five nonelectrical machinery investments last year.

The chemical industry attracted the second largest number of investments. Several were joint ventures. Nippon Sanso and Takeda Chemicals of Japan each formed joint ventures with U.S. companies to produce specialty gases: Courtaulds of England formed a joint venture with a U.S. company to produce carbon and graphic fibers; and Elf of France and Mitsubishi of Japan combined to form a joint venture, capitalized in excess of $20 million, to produce substances used in making plastics. As in previous years, a number of foreign companies announced construction of plants to produce industrial gases; BOC of England revealed that it will spend roughly $29 million to produce gases in Indiana and California; and AGA AB of Sweden announced an outlay of $22 million for construction of an industrial gas plant in Ohio.

(Neither foreign nor domestic firms routinely announce the cost of each of their investments, and thus only partial data are available. Spending figures are available for 159 of the 280 investments announced last year, and these figures total $2.9 billion.)

In the food industry, Japanese firms have become increasingly frequent builders and acquirers of plants whose output is often sold in the United States, as well as exported to Japan. Investments in this industry, however, continue to be dominated by Canadian and European companies such as Imasco, Seagrams, Nestle, United Biscuit, and Charterhouse Group, all of which announced U.S. investments last year.

Investments in the transportation equipment industry are less numerous than in other industries, but these invetments are often of substantial size. The joint venture between General Motors and Toyota to produce automobiles has cleared most, but not all, of its legal hurdles; if undertaken, the $150 million participation by Toyota would rank among the larger investments in recent years. Investments to produce automobile parts or busses were announced by Nikon Radiator and Nippon Cable of Japan; and by Guest, Keen and Nettlefolds (England), Saab (Sweden), and Volvo (Sweden). Other companies announced investments to produce helicopters, yachts and motorcycles.

Regional Benefits

As in previous years, New York State (with 36 investments) led all others in the attraction of foreign firms. A large number of these investments are undertaken by Canadian firms whose location in the northern part of the United States is a natural evolution of their growth in Canada. Many of the New York plants are located close to the parent companies who often have a difficult time viewing their U.S. operations as "foreign."

North Carolina (25 investments) was second to New York, followed by California (19), Texas (18), Illinois (14), Georgia and New Jersey (13 apiece). States such as California and Texas have traditionally accounted for a large share of foreign investments: California because of its attraction for Japanese firms and Texas because its well-developed industrial base, particularly in petrochemicals. Investments in other leading states are partly the result of aggressive outreach programs aimed at foreign companies.

In 1983, The Conference Board surveyed 256 governors, senators and representatives whose states or districts contained a Japanese-owned manufacturing facility.[1] The object of the survey was to elicit the views of elected officials concerning Japanese investments. While the survey was limited to an evaluation of Japanese investments, the responses also apply to capital inflows from other parts of the world as well.

Not surprisingly, in view of the efforts made by states to attract companies, elected officials welcomed them in virtually unqualified terms. An examination of their responses, however, revealed some inherently contradictory expectations regarding the benefits of foreign investments, as well as some disagreements as to what constitutes a benefit.

When asked to list the benefits of investments, "increased employment" was cited most frequently. Other advantages were the introduction of new management and production techniques, as well as new technology. As the report indicated, however, to the extent that investments incorporate new technology and production techniques, the investments are not likely to be labor intensive. Thus, state and local development officials are forced to weigh carefully the trade-offs offered by foreign companies and to structure out-reach programs to meet the sometimes conflicting needs of their economic regions.

Some respondents noted that foreign companies offered a new source of competition for U.S. companies, but there was no unanimity as to whether this constituted a benefit or a liability. Those who viewed competition as a liability feared that foreign companies might grow at the expense of U.S. companies, and that employment in these companies might consequently decline. Those who viewed competition as a benefit were confident of the ability of U.S. companies to rise to the challenges posed by foreign companies.

David Bauer

[1] *Japanese Investment in the United States: An Opinion Survey of Elected Officials,* Audrey Freedman and David Bauer, The Conference Board, 1983.

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April 1984

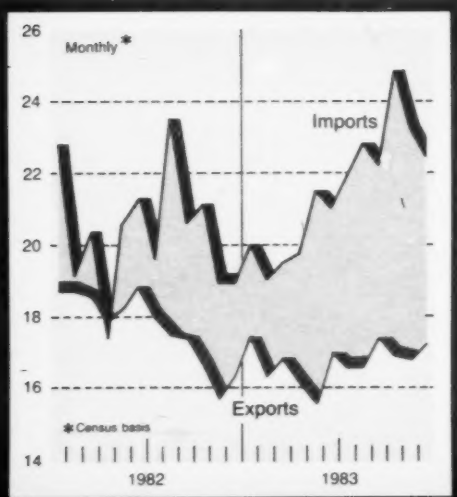
U.S. FOREIGN TRADE IN 1983
Spilling Red Ink

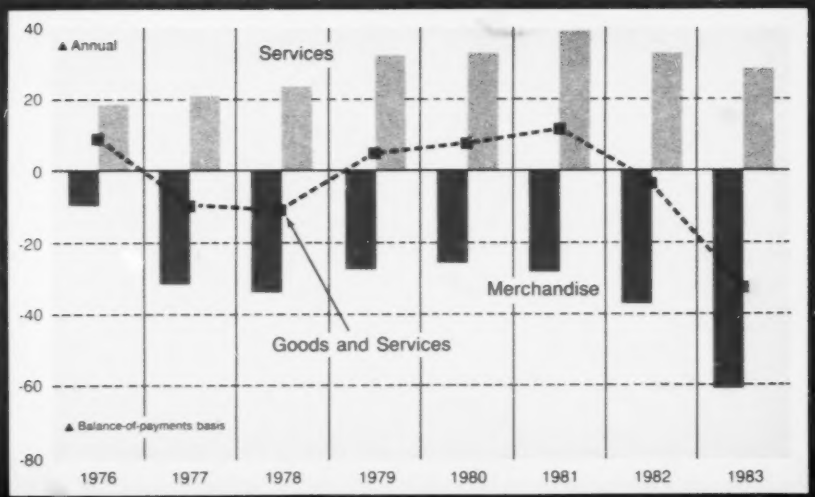
Americans, it used to be said, could afford to conduct their economic affairs without paying much heed to the rest of the world. Over the past few years, however, this attitude has been shattered as declining exports and rising imports led to increasing unemployment in export and import-competing industries—and, in its wake, to mounting pleas for protection.

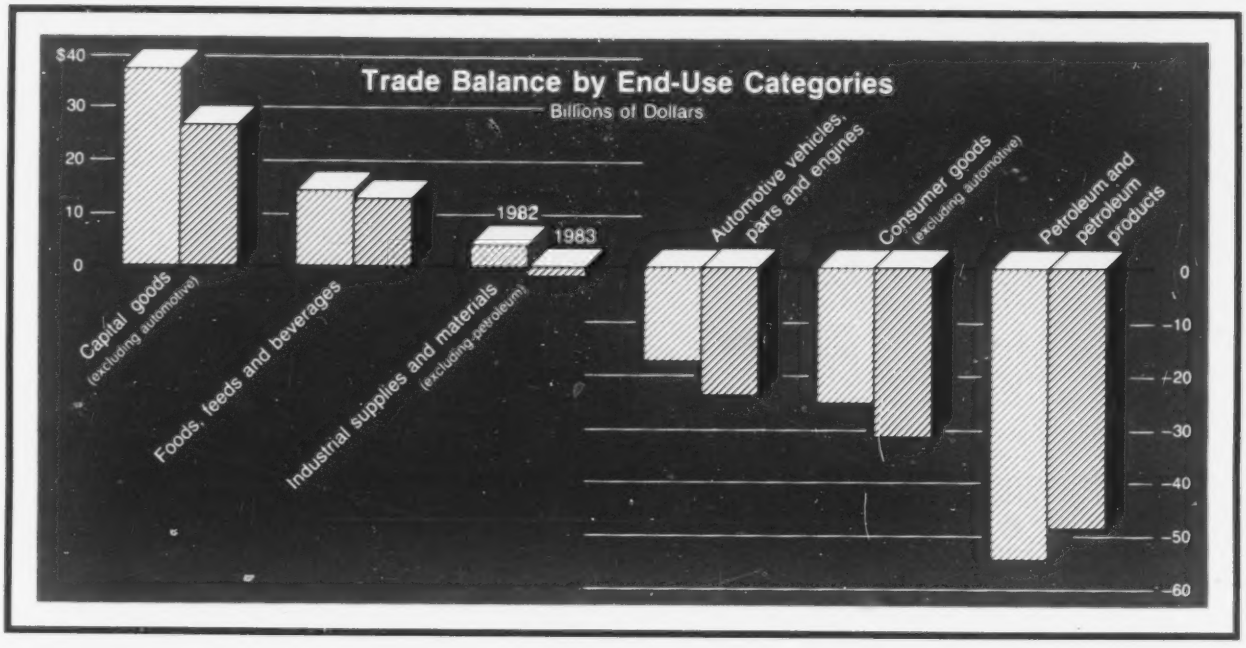
Thus, United States merchandise exports declined from $233.7 billion in 1981 to $200.5 billion last year, a 15 percent drop. (Total world exports declined by only 11 percent over the same period.) United States merchandise imports fell slightly from $261.0 billion in 1981 to $258.0 billion in 1983 (having receded the year between to some $244 billion). As a result, the United States trade deficit grew from $27.3 billion to $57.6 billion over the two-year period. If imports are valued on the so-called c.i.f. basis (see box on page 3), the deficit jumped from $39.7 billion to the mammoth $69.4 billion prominently featured in the press.

The effect of these changes on employment are more difficult to document. A recent study by the Department of Commerce found that in 1982 United States exports generated a total of 4.9 million jobs in all sectors of the economy, and that each $1 billion of exports supported an average of 25,200 jobs. (The corresponding figures for 1980 had been 6.2 million and 28,000, respectively.) The study also found that changes in export-related jobs had a greater-than-proportionate effect on total United States employment. Thus, the 20 percent drop in total export-supported jobs between 1980 and 1982 accounted for 40 percent of the increase in unemployment between the two years.

United States Trade Balance
Billions of Dollars







In the broader context of the national accounts, the decline in net exports of goods and services has had a sharply negative impact on total GNP. In 1982, the fall in net exports contributed 0.9 percent to the decline in real GNP, and last year it shaved 1.2 percent from the real GNP increase. Or, as Federal Reserve Chairman Volcker told the House Banking Committee in February: "It is the exporter, and those competing directly with imports, that have not shared at all proportionately in the recovery."

The most common, and on the surface the most persuasive, explanation for the deteriorating United States trade performance has been the strength or "overvaluation" of the dollar relative to other major currencies. Yet it would be an oversimplification to cite the strong dollar as the sole cause of the worsening of the United States trade account. First, the relationship between changes in exchange rates and changes in trade flows reflects a variety of decisions by both domestic and foreign producers and consumers and cannot be generalized. As one writer on the exchange market has put it: "No hard-and-fast rules can be laid down about these decisions."

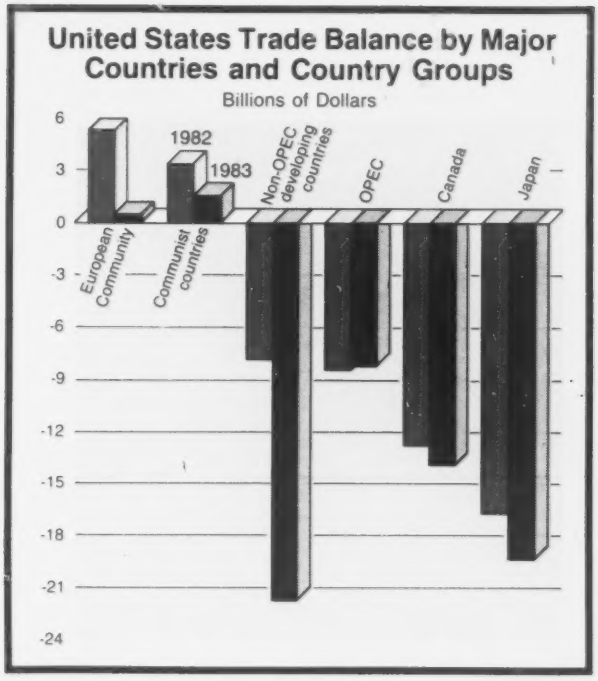
Second, the decline in United States exports in 1982 and 1983 can also be traced to factors other than the strong dollar—the lingering recession (and much slower recovery) abroad, the decline in OPEC revenues, and, above all, the financial squeeze on many heavily indebted developing countries. These strands cannot be sorted out neatly. They contain some intricate cross-connections and feedbacks that do not lend themselves to simple analysis.

Tallying 1983

Both the United States trade and current accounts have deteriorated sharply within the span of a few years. As recently as 1981, the United States current account (the broadest measure of the country's international position) had recorded a $5 billion surplus, as the merchandise trade deficit was more than offset by large services earnings, mainly income on foreign investments. But the trade deficit in the last quarter of 1983 exceeded $90 billion (at an annual rate), while many categories of services weakened at the same time. For instance, the recession abroad and the strength of the dollar both lowered earnings from direct foreign investment, so that the 1983 surplus on services (or "invisibles") shrank to $28 billion. This resulted in a current-account deficit of $41 billion.

These overall figures, however, are believed to be far from accurate. In the past few years, so-called unrecorded transactions have shot up sharply. For the world as a whole, the discrepancy between measured payments deficits and surpluses now amounts to about $100 billion. Much of the reporting problem (or underreporting, as it were) involves investment income, transportation receipts, and various kinds of contractual and professional fees. The United States, the Morgan Guaranty Trust Company pointed out recently, "has a leading position in world services trade, so it is likely that sizable earnings escape the official accounts. The current account deficit may therefore be overstated $20 billion or more."

The most significant element in the poor United States trade performance last year, accounting for virtually all



of the increase in the deficit, was a further decline in the balance on manufactured goods. In this category alone, the deficit widened to $38.2 billion from $10.6 billion in 1982. Since 1980—when a surplus of $12.5 billion was recorded—the adverse shift in trade in manufactures has exceeded $50 billion. Similarly, the 1981 surplus of $25 billion on trade in agricultural products and raw materials last year fell to about $17 billion.

The strength of the dollar has, without doubt, been one element in the growing United States trade deficit and the prime cause for the losses suffered by U.S. exporters in world markets since 1981. But another—and perhaps equally important—reason has been the different timing and pace of the economic recovery in this country and abroad. The 3.3 percent real GNP growth in this country last year was matched more or less in Canada and Japan—but was far in excess of the rate of 0.7 percent recorded by Europe countries. This difference shows up fairly closely in the trade statistics. In 1983, the United States deficit with both Canada and Japan—this country's most important trading partners—did not widen significantly (see table). On the other hand, the United States incurred a trade deficit with most major European countries and its normal surplus with Western Europe as a whole virtually disappeared.

The U.S. trade accounts have also been affected by the debt situation in the developing world, particularly in Latin America. Thus, the 1983 drop in United States sales to Latin America was two-thirds of the total export

Valuing U.S. Imports

Beginning in January, 1974, the Bureau of the Census has published two sets of data for U.S. imports (and hence for the U.S. trade balance). In addition to the so-called f.a.s. or customs value (representing "the transaction value of imports at the foreign port of exportation"), the data also show the so-called c.i.f. value (which includes "all freight, insurance, and other charges . . . incurred in bringing the merchandise from the country of exportation and placing it alongside the carrier at the first port of entry in the United States").

Some caution is indicated when looking at the c.i.f. figures only. To the extent that freight and insurance services connected with U.S. imports are supplied by U.S. firms, they do not represent international transactions, and hence do not generate "outflows" of dollars or additional accumulations of dollars to foreign owners. In other words, measuring imports on a c.i.f. basis is tantamount to implying that the United States provides none of the associated services.

Yet, the monthly trade data that are seized upon so eagerly by the media are on a c.i.f. basis; the corresponding f.a.s. data are released only 48 hours later and generally are not reported by the press. The published trade deficit of the United States with the rest of the world thus tends to be overstated each month; on an annual basis, the difference between the two sets of data becomes considerable (see tabulation). This also means that the often-heard assertion that the growth in the trade deficit will eventually have to weaken the dollar is based on figures that do not entirely represent dollars going to foreigners.

U.S. Trade Balance ($ billion)

	f.a.s.	*c.i.f.*
1974	- 4.5	-12.8
1975	+ 9.1	+ 1.8
1976	- 8.3	-17.3
1977	-26.5	-36.4
1978	-28.5	-39.6
1979	-24.6	-37.2
1980	-24.2	-36.4
1981	-27.3	-39.7
1982	-31.8	-42.7
1983	-57.6	-69.4

Ten Leading U.S. Trading Partners, 1983

Exports		Imports	
Total	$200.5 bill.	Total	$258.0 bill.
(1) Canada	17.3%	( ) Canada	20.2%
(2) Japan	9.9	(2) Japan	16.0
(3) United Kingdom	4.8	(3) Mexico	6.5
(4) Mexico	4.1	(4) Germany	4.9
(5) Germany	3.9	(5) United Kingdom	4.8
(6) Saudi Arabia	3.9	(6) Taiwan	4.3
(7) Netherlands	3.5	(7) South Korea	2.8
(8) France	2.7	(8) Hong Kong	2.5
(9) South Korea	2.7	(9) France	2.3
(10) Belgium	2.3	(10) Italy	2.1
	54.8%		66.4%

decline of $11.7 billion. Moreover, Mexico, which is this country's fourth largest market and accounts for nearly half of our exports to Latin America, was among the first of the Latin American countries to curtail its imports because of financial difficulties. The full impact of the economic contractions in Brazil and Venezuela made itself felt only last year. The decline in exports to Latin America since 1981 has affected every major category of United States exports. It has been particularly pronounced in several major industries—such as machinery, transportation equipment, and iron and steel products—that were already hard-hit by the 1981-1982 recession.

More Red Ink in 1984

In attempting to project the course of U.S. foreign trade in 1984, a number of commentators have pointed to what they consider the inevitable weakening of the dollar this year and thus to a turnaround, or at least an improvement, in the U.S. trade accounts. But as the preceding discussion has shown, the decline in United States exports over the past two years or so is only partly related to the strength of the dollar. Factors other than the dollar that have affected U.S. exports adversely are likely to continue exerting their influence, at least for the remainder of 1984. Early estimates speak of a trade deficit of perhaps close to $100 billion.

First and foremost, the cyclical divergence between the United States and Western Europe is likely to persist. As the Conference Board's *International Economic Scoreboard* noted at the beginning of the year: "In Europe... the recovery is developing more gradually than in North America and Japan. The combined leading index for France, West Germany, Italy and the United Kingdom was rising at an annual rate of 6 percent in October, while the leading index covering the United States, Canada and Japan was climbing at a 15 percent rate."

Second, while the debt situation of the developing countries, most importantly those in Latin America, currently is under control, it is not going to be resolved in a period as short as a year. The borrowing requirements of the LDC's will remain quite high for some time to come, necessitating substantial financial flows from banks and international financial institutions as well as continued retrenchment at home. Only strong and continued growth in the industrial world will give these countries the chance to resolve their debt problems satisfactorily. Nor does it appear likely that oil prices will shoot up once more to levels that would permit the OPEC countries to become substantial buyers of United States products.

As to the dollar itself, most analysts agreed early this year that any weakening in 1984 would be slight—amounting to no more than between 10 and 15 percent on a trade-weighted basis (i.e., against a basket of 15 major currencies). But it needs to be stressed that over one-third of U.S. exports go to four markets—Canada, Japan, Mexico and the United Kingdom. The currencies of those four countries are unlikely to strengthen against the dollar by as much as 10 to 15 percent.

That is not to say, of course, that in the longer run a marked decline in the dollar cannot improve United States international competitiveness again. Thus, during 1978-1980, when the dollar fell sharply, United States exports were able to grow at double the rate of world trade generally, and actually recaptured the share of world exports of manufactures that they had lost earlier in that decade.

At the Conference Board's annual Financial Conference in February, one speaker asked: "Can any company export today?" He went on: "The answer for most United States firms is pretty clear...only with difficulty. Yet, final results for 1983 also confirm that many are still exporting, even as others suffer collapse in orders and shipments." He then outlined other elements of the "marketing mix" that he saw as becoming increasingly important in the face of a strong dollar: "A new or differentiated product; a more accommodative distribution system; or a better-targeted promotion. But each possible offset involves an upgrading of marketing budgets and more financial risk." It is clear, he concluded, "that few U.S. exporters can hope for any repeat of success stories of the 1970's variety without extraordinarily hard work."

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June 1984

FOREIGN CAPITAL EXPENDITURES BY U.S. COMPANIES
Reaching for a New Peak

There is a clear-cut slow in the attitude of many United States manufacturers toward expending money for plant and equipment in foreign countries in 1984. At the same time, even more are proceeding with caution.

According to the latest survey (April 1984), nearly 39 percent of the respondents plan to spend more in 1984 than in 1983. This was well above the 34 percent who replied in the same way to the previous survey (October, 1983). It is nearly double the 20 percent who had plans for expanded plant and equipment expenditures when queried a year ago (in April, 1983). (At that time, the comparison was of expenditures in 1983 with those for 1982.)

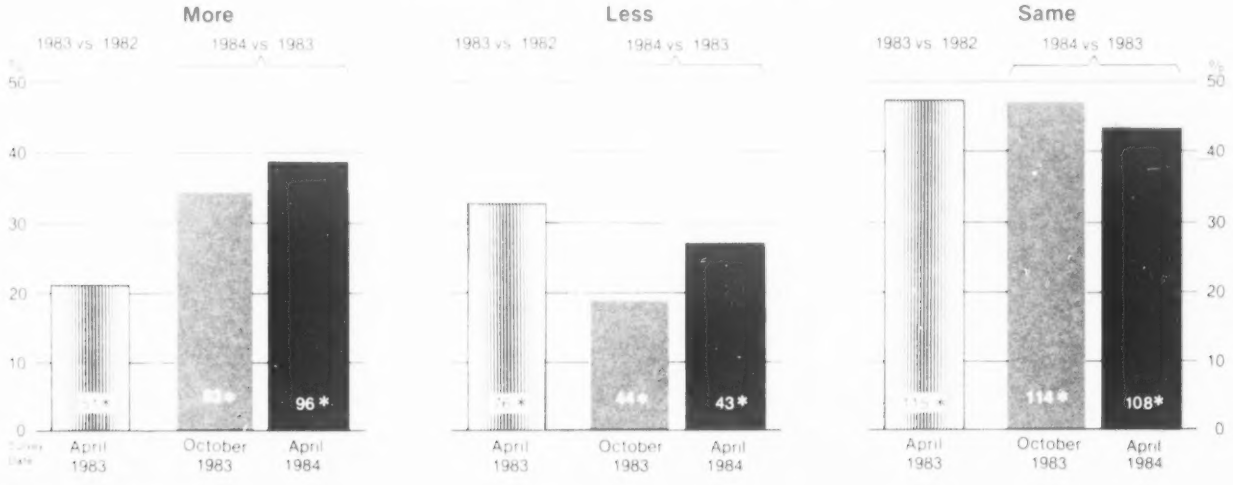
At present, still nearly 44 percent of the companies plan to spend about the same in 1984 as in 1983. This proportion is moderately down from the prior survey, when 47 percent of the respondents indicated that they planned to hold to the level of 1983.

The survey conducted by The Conference Board is aimed only at comparing the direction of current investment intentions with past levels on a company-by-company basis, without seeking dollar magnitudes. In the December, 1983 survey of the Department of Commerce (the latest aimed at estimating capital spending in dollars), manufacturers (including petroleum companies) stated that they expected to spend a little more than $35 billion in 1984, a 13 percent increase over 1983. Even if this substantial increase is realized, such expenditures will still be slightly below the record 1982 level.

J. Frank Gaston

Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend



*Number of companies

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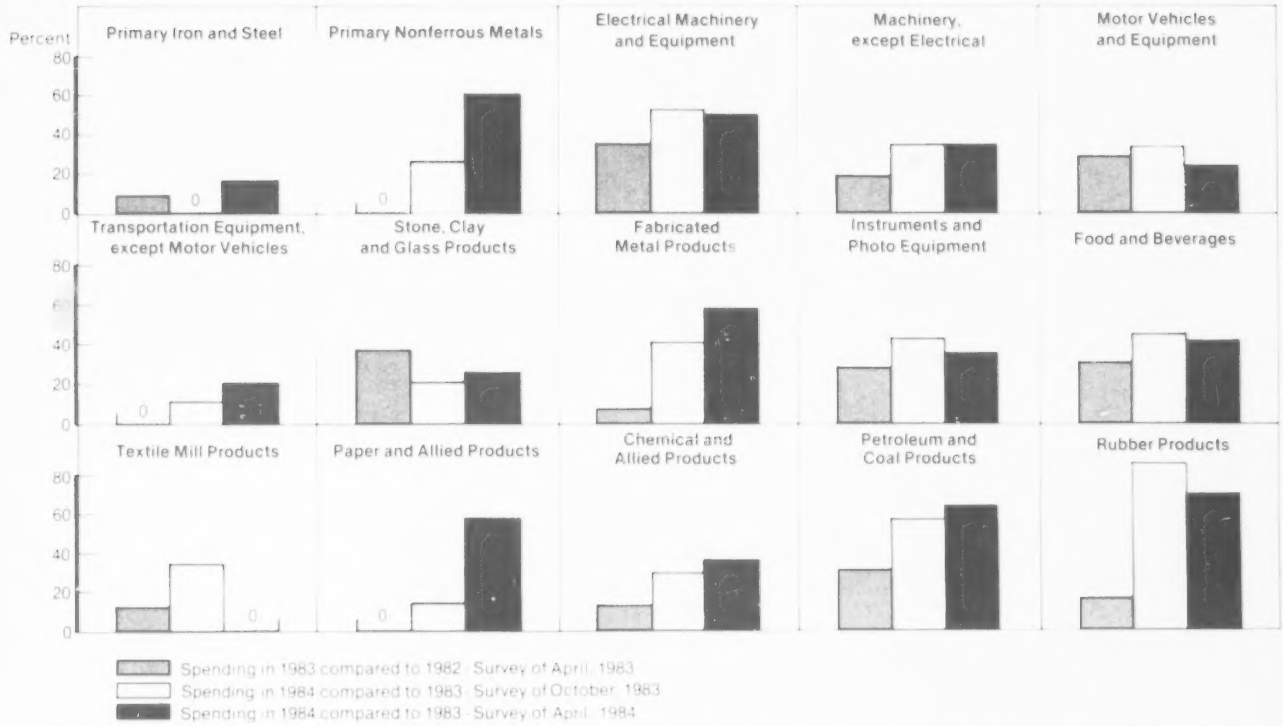
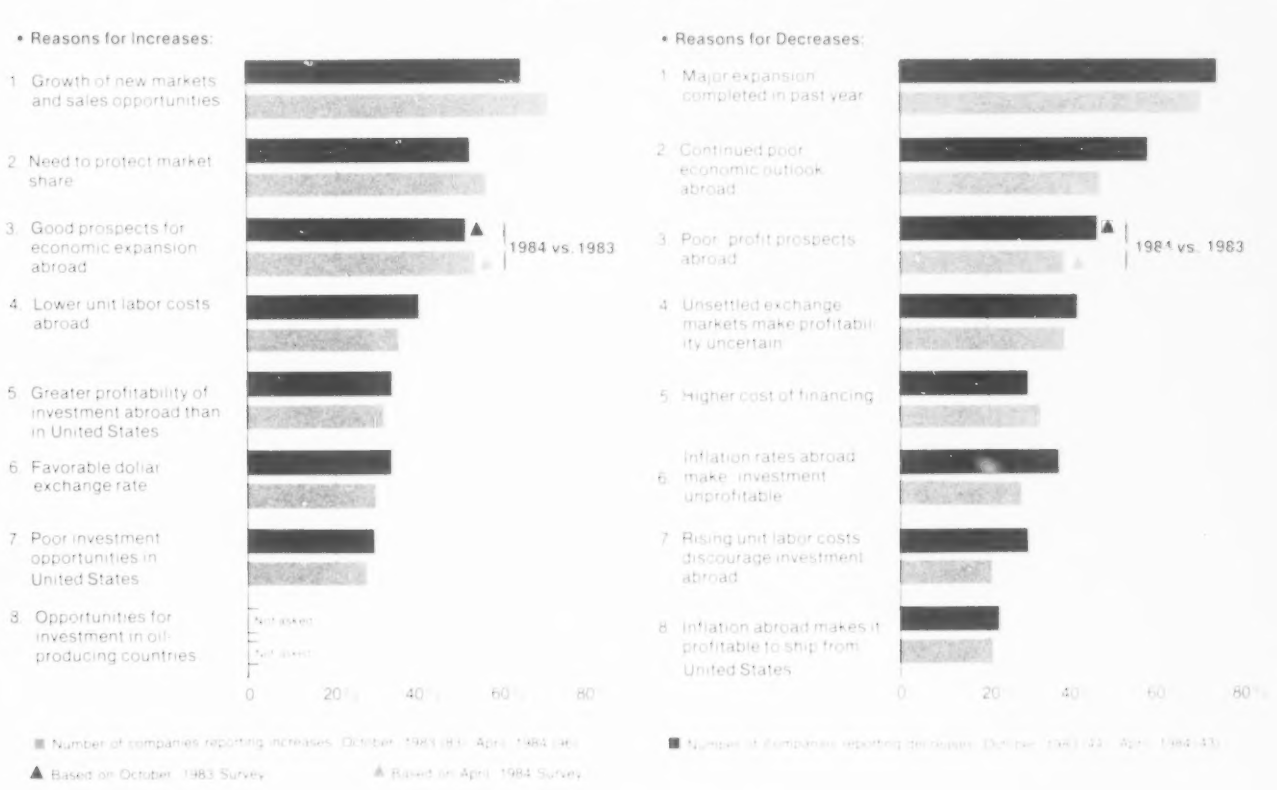
Spending Plans for Plant and Equipment Outside the United States by Industry

Percent of Companies Planning to Spend More


Percent
Primary Iron and Steel
Primary Nonferrous Metals
Electrical Machinery and Equipment
Machinery, except Electrical
Motor Vehicles and Equipment
Transportation Equipment, except Motor Vehicles
Stone, Clay and Glass Products
Fabricated Metal Products
Instruments and Photo Equipment
Food and Beverages
Textile Mill Products
Paper and Allied Products
Chemical and Allied Products
Petroleum and Coal Products
Rubber Products
Spending in 1983 compared to 1982 : Survey of April, 1983
Spending in 1984 compared to 1983 : Survey of October, 1983
Spending in 1984 compared to 1983 : Survey of April, 1984

Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing


Percent of Companies Reporting
• Reasons for Increases:
1. Growth of new markets and sales opportunities
2. Need to protect market share
3. Good prospects for economic expansion abroad
4. Lower unit labor costs abroad
5. Greater profitability of investment abroad than in United States
6. Favorable dollar exchange rate
7. Poor investment opportunities in United States
8. Opportunities for investment in oil-producing countries
1984 vs. 1983
Not asked
Not asked
0
20
40
60
80
• Reasons for Decreases:
1. Major expansion completed in past year
2. Continued poor economic outlook abroad
3. Poor profit prospects abroad
4. Unsettled exchange markets make profitability uncertain
5. Higher cost of financing
6. Inflation rates abroad make investment unprofitable
7. Rising unit labor costs discourage investment abroad
8. Inflation abroad makes it profitable to ship from United States
1984 vs. 1983
0
20
40
60
80
Number of companies reporting increases: October, 1983 (81); April, 1984 (96)
Based on October, 1983 Survey
Based on April, 1984 Survey
Number of companies reporting decreases: October, 1983 (33); April, 1984 (43)

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PRODUCTIVITY IN MANUFACTURING
A New Country Alignment?

Productivity (output per employee hour) in United States manufacturing leaped sharply upward in the year ending 1983, the most recent one for which data are available. The rise was so sharp as to exceed that of any year back to 1950 except for 1962-1963 when a rise of more than 7% was recorded.

Early indications are that this surge in productivity continues into 1984, and perhaps at nearly the same high rate. A crucial factor will be the pace at which manufacturing output continues to expand.

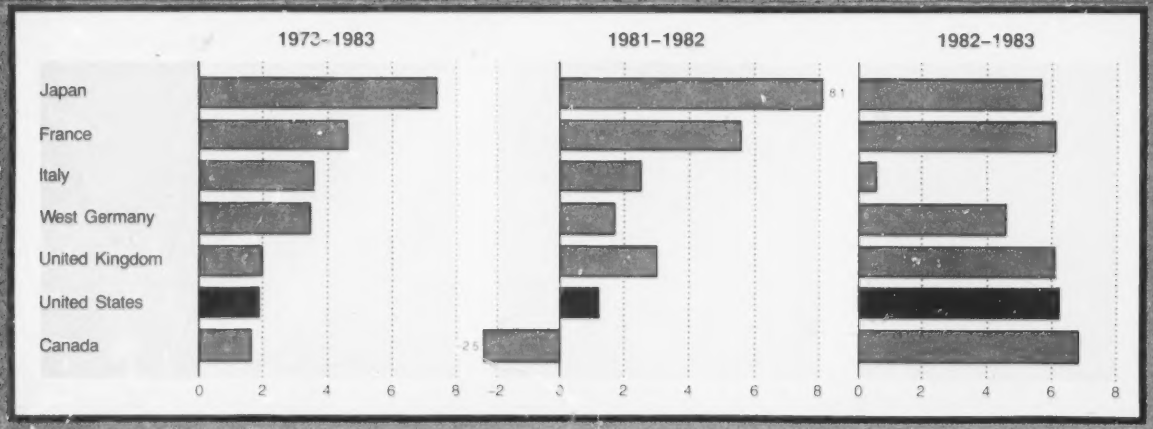
As a result of the sharp jump in United States productivity, it held second place in the ranking of the seven major manufacturing countries in the world. By contrast, it was next to last in the year before and in the ten year interval, 1973-83.

Canada also showed a sharp gain in 1983. As a matter of fact, its 6.8% increase made it first in 1983, a sharp turnaround from the 2.5% drop of the year before.

The jump in United States productivity has been accompanied by a similar experience in nearly all of the principal industrial countries of the world (see chart below). All of the countries, except Italy, show an annual rise of more than 4% in manufacturing productivity, a sharp improvement over their performance last year as well as the average of the past ten years. Italy showed a sharp decline in 1983 from the year before so that there was only a .6% rise recorded.

Japan too exhibited exceptional behavior. It, like Italy, showed a drop in productivity growth in 1983, but even so, productivity as still advancing at a high rate. The 1983 increase in Japan in Japan of 5.7% placed it in fifth position among the seven countries. By contrast with its record of the past ten years, however, the 1983 performance in this country is something of a comedown.

Manufacturing Productivity Compared
Average Annual Rate of Change per Employee Hour



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What is one to make of this sharp break in recent historical experience? Is there any suggestion in these data that the United States and Canada will change their accustomed position of being at the bottom of the international productivity race? Given the factors that have brought about this abrupt change in the rate of productivity growth in individual countries, what implications are there for the future?

Part of the answer to the question of how much of a break does the 1983 record make with past experience is presented in the first chart. For every country but Italy and Japan, the 1983 experience is so much better than that of 1973-83.

If the historical record is examined for a more remote period, however, the 1983 performance appears to be less spectacular. In the 1960-73 period, France, Germany showed a sustained productivity growth that exceeded the 1983 experience. So did Italy and by a wide margin since 1983 growth was down to nearly one-half of a percentage point. In Japan, productivity growth was proceeding at a 10.7% annual rate, well above that of any other country and well above its still-high 1983 performance.

Output per Employee Hour,
A Long Look
Average Annual Rates of Change

	1960-73	*1973-83*
United States	3.0	1.9
Canada	4.5	1.7
Japan	10.7	7.4
France	6.7	4.6
Germany	5.7	3.5
Italy	6.9	3.6
United Kingdom	4.4	2.0

Only in Canada, the United Kingdom and the United States was the 1960-73 record poorer than the one in 1983. Even so, productivity was moving upward at respectable rates for all three. Respectable in these cases meaning that the rates were above those prevailing in the decade 1973-83.

The 1983 surge then is at variance with the recent past. It does not, however, represent a break with longer historical experience. There is precedence for the welcome productivity jump that occurred.

Productivity changes as recorded in the usual statistics are notoriously subject in the short run to fluctuations in economic activity. There is no surprise in this since the customary procedure used to calculate productivity is to compare the change over time in an indicator of output with an indicator of input. A change in either series will affect the calculated measure of productivity. Generally, the input used is total employment or total workhours that has been employed to produce the output. These component statistical series do not always move in step and, consequently, may bring about changes in the productivity indicator. These changes are not necessarily reflective of any alteration in underlying technique of manufacturing or efficiency in the use of resources.

As an extention of this feature of most productivity measures, one should also guard against interpreting them as indicating neat cause and effect. Expressing productivity as output per employee hour is largely a matter of convenience and does not mean that the identified input is solely responsible for the identified output.

The production process is a complicated one in which technology, capital investment, capacity utilization, energy use, managerial skills all play a part. To attribute to each factor a quantitative importance in bringing about changes in output is extremely difficult, although efforts have been made. The statistical difficulties are nearly impossible to overcome. As a result of the availability of data on employment and hours, the usual practice is to use the output-employee hour ratio as an indicator of productivity or of productivity changes.

The seven countries fall into two distinct groups upon examination of the immediate factors bringing about the 1983 changes. On the one hand are the United States, Canada and Japan, linked because their 1983 productivity growth is due largely to significant upswings in manufacturing output, each showing a rise of more than 6%. Among these countries, changes in total hours were relatively slight and, therefore, played only a small part in the movement in the statistical indicators of productivity. The increase in productivity was the result of sharp rises in output with only minor changes in the input of employee hours.

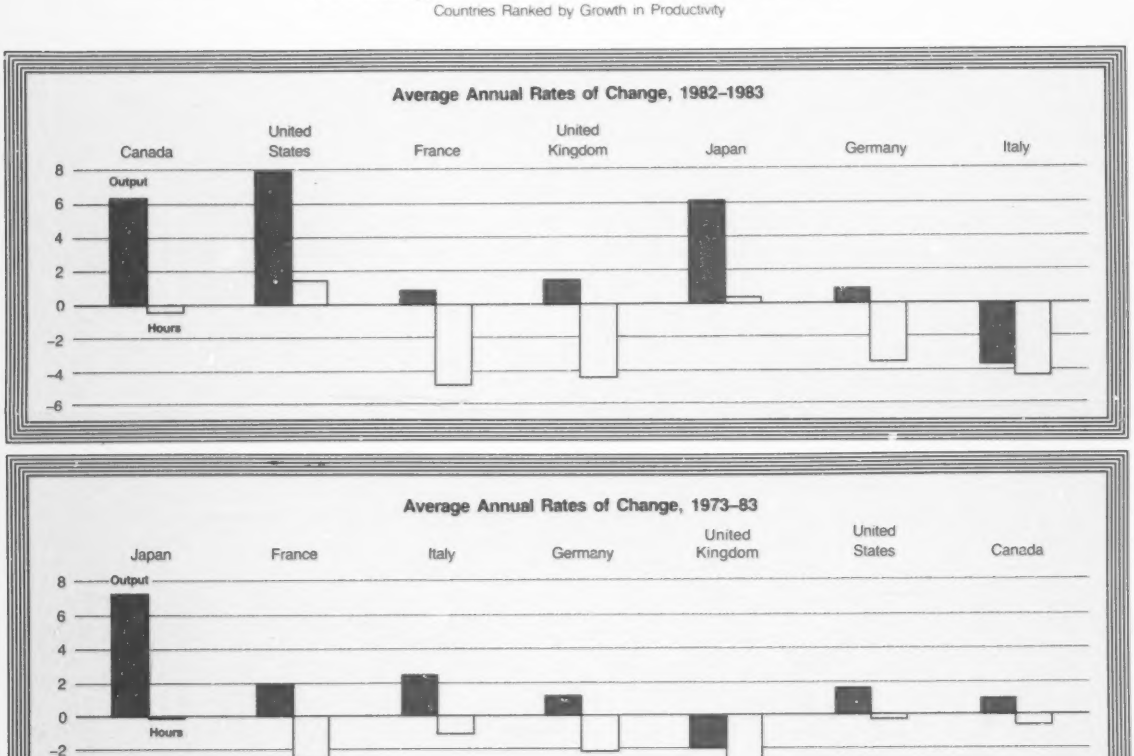
By contrast, three countries—France, Germany and the United Kingdom—showing increases in 1983 productivity, two of them substantially, the change in output has been relatively modest. In Italy there was an actual decline in output, while productivity increased to a minor extent.

What accounted then for their relatively bright record in productivity? The immediate answer as recorded in the statistics for these countries was the sharp decline in employee hours. In all four countries, there was a substantial drop in total hours ranging from nearly 5% in the case of France to 3.5% in the case of Germany. Moreover, the 1983 drop in hours continued the decline experienced in the two previous years. During these same three years, 1981-83, employment dropped sharply as well.

The two groups are differentiated, therefore, primarily by the timing of their economic expansion. In the first group of countries, economic expansion was already taking hold, in the United States quite vigorously. In the second group of countries, no such expansion had yet taken hold. As a matter of fact, these were still in the contracting phase as evidenced by the fact that they were continu-

Accounting for Productivity Growth in Manufacturing

Countries Ranked by Growth in Productivity



ing to reduce hours in 1983 at about the same pace as in the immediate past while output was advancing modestly if at all.

If the principal industrial companies in Europe were able to maintain productivity increases by reducing hours in the face of little or no growth in output, what would happen if their manufacturing industries were to come alive in 1984. The answer is obvious enough: productivity would expand. To what extent is that likely to happen?

There is already some partial indication in the regular statistical series that manufacturing output is expanding in 1984, at a somewhat faster rate than in 1983. Second, there appears to be some evidence from surveys of businessmen that future business prospects are looking up. This is far from conclusive since the indications are weak and since these surveys rest upon judgments about the future, they are easily subject to change in the light of developments.

Third, since businessmen report that capacity is far from being fully utilized a growth in demand could largely be met from existing facilities. This possibility provides a setting for a statistical rise in productivity.

It appears that the 1983 experience may be repeated in 1984. Certainly for the United States, prospects for 1984 look very favorable since recorded manufacturing productivity in the first half advanced at about the same pace as in 1983. But what about 1985 and beyond? Will it take its accustomed position near the bottom of the pack?

Japan, normally far out in front, has faltered lately. Does this represent a new fundamental position in a new economic environment or only a temporary setback? Once manufacturing picks up will Japan resume its leadership position?

All the factors that impinge upon the long-term future course of productivity cannot be examined here. There is virtually no end to the factors that have been identified as having some force in increasing productivity. Technological advances, research and development expenditures, business capital investment, economies of

scale, changing composition and quality of the workforce, substitution of one production factor for another, e.g., energy for human power, investments in human capital, employment of resources in industries with higher productivity, managerial capability and creativity, change in product design, extent of the regulation of business enterprise for other purposes, e.g., pollution control, financial incentives, tax deterrents and other actions by government that wilt or foster business growth.

All of these factors can interact, of course, so that it is no easy task to attempt to assign a quantitative role to any of them. All of these factors have been examined, but so far not with clear-cut success.

In attempting to peer into the future, it is vital to examine the long-term record of productivity changes among these seven countries. As already noted, all of them exhibit a tendency for short-term changes in productivity to react sharply to changes in output and in input measured in hours. Despite these sharp changes from year to year, over the long term, these countries have not changed their relative position to any major extent.

The countries are ranked by the rate of productivity growth in the period 1973-83 in about the same order as they were in 1960-73. Going back even further, the ranking in the decade 1950-60 does not differ to any significant extent from the more recent periods.

Ranking in Average Annual Rate of Growth in Output Per Employee Hour in Manufacturing

	1973-83	*1960-73*	*1950-60*
Japan	1	1	1
France	2	3	4
Italy	3	2	3
Germany	4	4	2
United Kingdom	5	6	6
United States	6	7	7
Canada	7	5	5

Ranking the countries of productivity growth over substantial periods of time as in the table above serves to neutralize the impact of the business cycle to a substantial extent. Short-term changes in output and in input of hours, which can affect the position of countries as evidenced by the 1983 experience, are ironed out by extending the period of observation. By implication then, the other factors deemed important to productivity are emphasized by this ranking.

The relative stability in ranking suggests that some major change in the economy of individual countries must occur (not concurrently taking place in the others) before it can change its position. The implication is that of the many factors underlying productivity changes, none has so changed as to lift one country to the top that previously was at the bottom. Similarly, none has fallen sharply from its earlier high position.

Of all factors cited above, the one that can be regarded as of prime importance in assessing the future course of productivity is capital investment, particularly in business capital. Not only is capital investment by business an important factor by itself, it can also be regarded as an important proxy or embodiment of other factors cited above. The impact of research and development expenditures, for example, is often through new capital expenditures.

In this respect, there appears to be no significant change in the record of the countries that would have some long-term implications. The United States has regularly been ranked at the bottom with respect to the proportion of gross domestic product devoted to capital investment among the seven industrial countries. Japan has regularly ranked at the top with respect to this factor.

There appears to be nothing in the offing that would make for a quick change of such a ranking. The output of investment goods in the United States has shown a sharp rise early in 1984, about in step with industrial production. The percentage of output, therefore, devoted to capital investment cannot have changed materially.

In Japan, about the same behavior is exhibited, although both output of investment goods and overall industrial production has increased at a somewhat slower rate than in the United States. The differential change has been slight in the case of both countries. In the light of the fact that Japan traditionally has had a ratio of gross domestic investment to gross domestic production nearly twice that of the United States, these small differentials for such a short period cannot have any influence in changing the respective rankings.

Canada and the principal industrial countries in Europe have also historically devoted a higher percentage of their output to gross investment than the United States. So far no evidence points to a change in this position. It is reasonable, therefore, to interpret the recent high growth rate of productivity in the United States as a cyclical phenomenon and not the beginning of a realignment of its ranking among the major industrial countries. The continued current expansion of manufacturing output here will serve eventually to press against available resources resulting in a slowup in productivity growth. Meanwhile, there are grounds for expecting productivity, as customarily measured, to increase in the other industrial countries.

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